BEFORE THE
DEPARTMENT OF TRANSPORTATION
OFFICE OF THE SECRETARY
WASHINGTON, D.C.

In the Matter of		
	Dockets	**OST-97-2881**
COMPUTER RESERVATIONS SYSTEM (CRS) REGULATIONS		**OST-97-3014**
		OST-98-4775
		OST-99-5888

REPLY COMMENTS OF NORTHWEST AIRLINES, INC.

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Northwest Airlines, Inc. ("Northwest") hereby submits its reply comments on the Department's Computer Reservations Systems ("CRS") Notice of Proposed Rulemaking ("NPRM"), published in the Federal Register on November 15, 2002.[1]

INTRODUCTION

After the latest round of comments in this proceeding, one fact remains undisputed: with the forthcoming divestiture of Worldspan by its airline-owners, the original rationale for regulating the CRS business will have all but disappeared. Only one system, Amadeus, will remain with any airline ownership. And, as to that system, any concerns over the potential for airline-owner leveraging of CRS market power are largely, if not entirely, dissipated by the absence of any U.S. airline ownership and the dispersal of equity interests among its three

[1] 67 Fed. Reg. 69366 et seq. (Nov. 15, 2002). Throughout its Reply Comments, Northwest will refer to initial comments submitted in this proceeding by the commenter's common name, followed by a page number for reference. For example, a citation to Comments of Northwest Airlines, Inc. will be "Northwest at __."

foreign airline owners and the public. The time has come, therefore, to end government regulation of CRSs.

The Department, however, cannot responsibly just abandon the field without taking some action to ameliorate the market-distorting effects that two decades of regulation have created. Indeed, the existing regulatory regime, rather than impeding the exercise of market power by CRSs, actually has contributed to its exercise. For example, the antidiscrimination rules have, by the CRSs' own admission, blocked airlines from negotiating lower booking fees,[2] while the mandatory participation rule has come to be used by CRSs to impose parity clauses in airline-CRS contracts that essentially strip the airlines of any opportunity to bargain over the level of the airlines' participation in the CRS. The effects of these regulations have become embedded in industry contracts, practices and relationships and will not be reversed, allowing the natural operation of market forces to emerge, simply by abolishing the regulations. Rather, affirmative steps must be taken to permit the development of market-driven bargaining positions and relationships among airlines, CRSs and travel agents.

Northwest thus continues to urge the Department to provide for a three-year transition period, during which the Department would enforce four limited and narrowly-targeted measures against legacy CRSs to mitigate the continuing effects of market distortions resulting from the prior regulatory scheme.

First, during the transition period, the Department should prohibit the enforcement of CRS contracts with travel agents in the event that an airline serving a city in which the travel agent operates no longer participates in the CRS. This transitional rule will help loosen the

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[2] *See, e.g.*, Worldspan at 19-20; Sabre at 143.

tethers of travel agents to particular CRSs, an important source of CRS market power and of the one-sided bargaining relationships between CRSs and airlines.

Second, during the transition period, the Department should require that parity clauses be stricken from CRS-airline contracts. These clauses serve no purpose other than to prevent airlines from negotiating for levels of service consistent with their individual needs.

Third, during the transition period, the Department should adopt a new rule barring systems from tying airline participation in a system to the airline making available to such system fares offered exclusively through particular Internet sites, access to particular Internet sites and other marketing or promotional benefits. Airline and some third-party web sites offer the potential of one day eliminating CRS market power that has become entrenched as a result of government regulation. If that potential is to be realized, the Department should not allow CRSs to thwart the development of these competitive alternatives through the exercise of their market power.

Fourth, during the transition period, the Department should retain its prohibitions on CRS display bias. Although the original concern justifying the rule – that owner airlines would favor their own services in CRS displays – no longer exists, consumers and travel agents have come to assume the absence of bias as a result of 20 years of anti-bias regulation.

As set out in its initial comments, Northwest is not confident that market forces, freed to operate by deregulation, will put an end to CRS market power in the immediate future. The existence of market power alone, however, does not justify continued regulation of the CRS business. Northwest believes that, as in other sectors of the economy, vigorous enforcement of the antitrust laws by the government or private parties ought to be relied upon to correct abuses of market power if and when they occur. Northwest thus urges the adoption of its proposed

transitional rules not on the ground that such transitional regulation is justified by the existence of market power, as such, but rather by the residual market-distorting effects of regulation that would otherwise survive the demise of the regulatory regime and continue to contribute to the exercise of CRS market power.

Finally, irrespective of whatever rules the Department ultimately adopts, it is essential that the Department complete its CRS rulemaking no later than the sunset date for the current CRS rules on January 31, 2004, and earlier if possible.[3] The sunset date already has been extended multiple times, and the time is now ripe for the Department to issue its final rules. Any other result would adversely affect industry participants and the public, and would be inconsistent with Secretary Mineta's expressed commitment to make the completion of the CRS rulemaking a "departmental priority."[4]

I. The CRS Business Should Be Completely Deregulated After A Short Transition During Which The Department Would Enforce Four Narrowly Tailored Rules To Redress The Market Distortions Created By The Existing Rules

While the participants in this proceeding advocate a wide variety of regulatory, policy and legal bases for addressing the complex relationships among airlines, CRSs and travel agents, there is near unanimity in the belief that the status quo cannot continue. Northwest agrees with most other commenters that the time has come to change the current CRS rules. In doing so, Northwest believes it is necessary for the Department to step back, consider the origin of the existing rules, understand the unintentional, adverse effects that the rules have had, and conclude

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[3] *See* 68 Fed. Reg. 15350 (Mar. 31, 2003) (extending the CRS rules' sunset date to January 31, 2004).

[4] *See* Letter from Department Secretary Norman Y. Mineta to the Hon. James L. Oberstar dated Nov. 5, 2002 (placed in Dkt. No. OST-97-2881 on Nov. 6, 2002).

this proceeding in a manner that specifically addresses those lingering effects while, at the same time, taking meaningful steps towards complete deregulation.

A. <u>The Rationale For The Current Rules Has Disappeared</u>

The Department's original CRS regulations were predicated on the assumption that airline ownership of CRSs resulted in distortions in both airline and CRS competition that needed to be addressed through regulation. Airline ownership of such systems (particularly, when each system was owned by a single airline) was thought to permit airline owners to leverage the market power of the systems to distort competition among airlines. In other words, when originally adopted in 1984, and amended in 1992, the CRS rules were meant to ameliorate potential abuses that could be directly attributed to vertically integrated airlines and systems. Today, that foundation, and the rules that it engendered, are a relic of a bygone era.

In the nearly twenty years since the precursor of the Department's CRS rules first were adopted, the fundamental premise of CRS regulation – airline ownership of CRS businesses – has vastly diminished in importance, if not disappeared altogether. As the Department is well aware, two of the legacy CRSs – Sabre and Galileo – are no longer owned by airlines. A third legacy system, Amadeus, has no U.S.-based airline ownership. The fourth legacy system, Worldspan, though currently owned by three major U.S. airlines, recently announced that its airline owners would be divesting their ownership interests.[5]

This dramatic change in circumstances has eviscerated the original rationale for the rules as a shield against competitive harms stemming from the potential for airline owners to leverage the market power of CRSs. Parties who contend otherwise, *see, e.g.*, British Airways at 2;

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[5] The Department should give no credit to the insinuations by certain parties that the airline-owners' divestiture of their interests in Worldspan may be "less than meets the eye." Sabre at 4. *See also* Travelocity at 5.

Midwest at 2, ignore that vertical integration was the key foundation on which the original rules rested, and fail to grasp the sea change that has occurred.

B. The Department Should Reject Claims That Marketing Agreements Provide A Basis For Continuing Regulation

Those who contend that marketing agreements between airlines and CRSs are the functional equivalent of vertical integration, and therefore justify continued regulation, are flatly mistaken. Galileo, for example, argues that "the airlines with CRS affiliations still have an incentive to misuse their systems to advance airline interests." Galileo at 8. It specifically points to the danger that airlines with marketing relationships with CRSs would "withhold participation in competing CRSs." *Id*. at 9. These claims cannot withstand even passing scrutiny.

Marketing agreements do not, even in theory, create the same incentives to distort competition in airline and CRS markets that the Department found to arise from vertical integration and to justify regulation of the CRS business. Thus, for example, airline ownership of CRS systems was thought to permit airline owners to leverage the market power of the systems to distort competition among airlines by "providing information to travel agents that gave an undue preference to the services operated by the owner airlines" (NPRM at 69367), prompting the Department to adopt the anti-bias rule, which prevented airline-owners from giving undue preference in CRS displays to their own services. *See, e.g*., NPRM at 69372. Similarly, the Department adopted prohibitions on discriminatory pricing of CRS services to prevent airline owners of CRSs from disadvantaging competitors by charging higher prices for the same level of service. *See, e.g.*, NPRM at 69399 (citing 49 FR 11651)). Each of these regulations was justified by a concern that airline owners could require the CRS they controlled to behave in a manner contrary to its independent economic interest as a CRS.

With the elimination of ownership ties, CRSs have no incentive to engage in conduct that would competitively advantage a particular airline with no corresponding benefit to the CRS. Indeed, the behavior Galileo predicts would not only provide no benefit to the CRS, but in fact would degrade its own service or cause it to forego revenues. Thus, for example, as a result of the admittedly vigorous competition among CRSs for travel agents, a CRS would have no incentive to arbitrarily favor an airline (even one with which it had a marketing relationship) because, to do so, would only cause it to lose business to competitor CRSs, as travel agents would choose to subscribe to an unbiased system. Similarly, absent ownership ties, no CRS would have an incentive to discriminate in price among airlines on non-economic grounds, since it would only be losing revenues by charging the favored airline a lower price than it would otherwise charge.

The Department also believed that integration of airlines into the CRS business presented opportunities to distort competition among CRS systems. Therefore, to guard against the potential that an airline owner might seek competitive advantage for its own CRS business by not participating in competing CRSs, or participating at a lower level than in its own CRS, the Department adopted the mandatory participation rule and permitted the enforcement of parity clauses in CRS contracts. *See, e.g.*, NPRM at 69393. Here too, absent vertical integration into the CRS business, an airline would have no incentive to withhold participation in particular CRSs, except to tailor its participation in a manner it believed would best meet its needs, allowing it to maximize its revenues from the sale of air transportation while minimizing costs.

The existence of a marketing arrangement with a CRS does nothing to change these incentives. Such marketing arrangements are nothing more than a means of reducing, to a limited extent, the booking fees airlines must pay to CRSs – an outcome that is not harmful, but

rather beneficial, to consumers. In the absence of ownership ties, there is no reason to suppose that airlines will choose to market a particular system other than on the competitive merits, including that system's willingness to reduce booking fees.

C. In Moving To Complete Deregulation, During A Brief Transition Period, The Department Must Address The Market Distortions Created By Twenty Years Of CRS Regulation

The Department should terminate CRS regulation. However, the Department cannot responsibly simply abandon the field without taking steps to redress the unintended consequences of 20 years of regulation. The existing CRS rules have actually operated to thwart their original purposes; rather than inhibiting the abuse of CRS market power, the rules instead have fostered and then exacerbated that market power, artificially limiting airlines' ability to bargain freely with both systems and travel agencies.

To address these concerns, the Department must take account of the reality of the airline ticket distribution market as it exists today. In an ideal world, Northwest would be among the most vocal advocates for complete and immediate deregulation. Unfortunately, however – and predominantly as a result of the current rules – industry participants do not inhabit an ideal world, as is well illustrated by one of the rules that received an enormous amount of attention in the initial comments – the mandatory participation rule. That rule, originally intended to keep airline system owners from withholding their participation in competing systems so as to benefit their own systems, now serves to allow CRSs to impose onerous parity provisions in airline-CRS contracts and limits airlines' ability to bargain at arm's length for mutually agreeable levels of participation. Moreover, as American's comments indicate, CRSs have been using parity provisions in an attempt to force airlines to provide Internet channel-specific fares, apparently in an effort to thwart the competitive threat posed by Internet sites. *See* American at 4-5, 24-28. As a result, CRS market power has been entrenched, and the natural bargaining position among

airlines, CRSs and travel agents has been distorted. Simple abolition of Part 255 will not remedy this legacy of competitive imbalance.

Therefore, in order to foster an environment in which competition eventually can flourish without any regulatory constraints, it is essential that the Department adopt four carefully focused transitional rules for a three-year period to counter the residual market distortions that are a product of nearly two decades of CRS regulation.

1. The Department Should Prohibit Enforcement Of CRS Contracts With Travel Agents If An Airline Serving The Agent's Market No Longer Participates In The CRS

The Department should prohibit the enforcement of CRS contracts with travel agents in the event that an airline serving a city in which the travel agent operates no longer participates in the CRS. Therefore, the Department should adopt the following rule, which would sunset three years after its adoption:

> No system shall enforce a contract term in a contract with a subscriber that would prevent a subscriber from immediately terminating its contract with the system without further penalty or obligation in the event that an airline which (i) provides service in the city in which the subscriber operates and (ii) participated in the system at the time the subscriber's contract was entered, no longer participates in the system. Upon receiving notice from an airline that it no longer will participate in a system, the system immediately shall notify all subscribers who maintain operations in cities served by such airline of that airline's decision to terminate its participation in the system, indicate upon what date such termination shall become effective, and inform such subscribers of the termination rights provided by this section.[6]

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[6] The term "subscriber" as used above should have the same meaning as in 14 C.F.R. § 255.3 (*i.e.*, generally speaking, a travel agent). The term "system" as used above should have the same meaning as in 14 C.F.R. § 255.3, subject to DOT's proposed revision of that definition (which eliminates airline-CRS cross-ownership as a component of the definition). The new rule could be added to the proposed new 14 C.F.R. § 255.7 ("Contracts With Subscribers"). (Note that, currently, 14 C.F.R. § 255.7 is titled "System owner participation in other systems." DOT proposed to eliminate this "mandatory participation" rule, and thus the rules relating to contracts with subscribers would be moved from their present location (14 C.F.R. § 255.8) to a new location, 14 C.F.R. § 255.7.))

As explained in Northwest's comments (at 14-16), this transitional rule addresses the key element of CRS market power – the ability of CRSs to lock in travel agents. As the Department has recognized, CRSs derive their market power, in significant part, from the need for major airlines, in order to reach customers served by travel agents, to participate in all CRSs at least to some degree. As long as CRSs are able to keep travel agents locked-in, they will be able to continue to wield market power over airlines. The key to unlocking this market power, as the Department has observed, would be to find a way that "airlines could practicably persuade travel agencies to use one system rather then another." This, in turn, would create for airlines "some bargaining leverage against the systems." NPRM at 69375 and 69381.[7] Northwest's proposed rule could contribute to the creation of such "bargaining leverage" by creating at least the possibility of significant travel agent migration to another CRS if an airline and a CRS are unable to reach agreement on the terms of its participation. This transitional rule would also provide protection to travel agents, as the industry enters a new environment, freed of the mandatory participation rule, in which there are at least no regulatory barriers to an airline ceasing its participation in a particular system.

2. The Department Should Prohibit The Enforcement Of Parity Clauses During the Transition Period

The Department should prohibit the enforcement of parity clauses against any airline. Given the changes that have occurred in the industry, parity clauses serve no purpose except to reinforce the market power of CRS systems and prevent airlines from negotiating from the menu

[7] While there will no doubt remain some practical impediments to many travel agents swiftly switching from one CRS to another, the threat that a CRS could be rapidly replaced, should contribute to some measure of greater equality in airline-CRS bargaining power. Such a rule also would protect travel agents from enforcement of contracts that require continued subscription to a CRS that no longer provides the complete range of airline services and fares for which the travel agent originally bargained.

of services offered by CRS systems the price/service mix that best meets their needs. Northwest is joined by a chorus of others in calling for a complete ban on parity clauses.[8]

The few commenters who support permitting parity clauses to be enforced against an airline that is somehow affiliated with a CRS, *see, e.g.*, British Airways at 7, offer no serious justification for hamstringing such airlines' negotiating flexibility. Likewise, Amadeus' attempt to link the permissible use of parity clauses to the elimination of the booking fee rule is misplaced. *See* Amadeus at 47. Northwest hopes that, after a three-year transition, the imbalances of the market should be sufficiently ameliorated to permit legacy systems to negotiate for parity clauses if an airline is willing to do so. In the interim, however, CRSs should be proscribed from wielding this blunt instrument against carriers that have different needs for different systems.[9]

3. The Department Should Bar CRS Tying During The Transition Period

During the three-year transition period, the Department should adopt a new rule barring systems from tying airline participation in a system to the airline making available to such system access to particular Internet sites and other marketing or promotional benefits.[10] Northwest proposes adopting the following rule – for a three-year transition period – which can be inserted as a new, last subsection to 14 C.F.R. § 255.6:

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[8] *See,* e.g., Air Canada at 11; American at 28; Continental at 16; Delta at 36.

[9] Galileo's effort to portray parity clauses as something that is mutually negotiated between airlines and systems, *see* Galileo at 24, ignores the market power that the legacy systems have amassed as a result of the current rules and the competitive harms associated with compelling common levels of participation with all systems.

[10] The Department itself is proposing to prohibit CRSs from tying an airline's ability to participate in a system (as used by "traditional" or "brick-and-mortar" travel agencies) with the airline making available to such a system access to particular Internet sites (and, by extension, certain fares that are limited to those sites). *See* NPRM at 69414-69415. This transitional rule should be adopted and expanded to prohibit tying with other marketing and promotional benefits.

> No system may require a carrier, as a condition of participation in a system, to make available to such system access to any particular Internet site, fares offered exclusively through particular Internet sites, or any marketing or promotional programs including, without limitation, frequent flyer or similar rewards, waivers or modifications to any restrictions otherwise imposed on particular fares, and other services or features available only through limited channels of distribution.

Affording airlines flexibility in negotiating the terms for participation in various distribution channels, access to Internet sites, and the terms for participation in marketing programs and promotions will augment the viability of Internet-based airline sites as an alternative means of airline ticket distribution.

In addition, Northwest's proposal will "be sufficient to prevent [legacy systems] from using an 'all or nothing' threat to shut down the development of such alternatives during the transition to a fully competitive and deregulated environment." Delta at 39. The fact that systems oppose such a rule, only reinforces the wisdom of the rule, for in its absence during a transitional period the systems likely would leverage their market power of "traditional" means of distribution into new means of distribution.

4. The Department Should Retain CRS Display Bias Rules During The Transition Period

The Department should retain its prohibitions on CRS display bias. Although the original concern justifying the rule – that owner airlines would favor their own services in CRS displays – no longer exists, consumers and travel agents have come to assume the absence of bias as a result of 20 years of anti-bias regulation. This assumption should not be disturbed during the three-year transition period.

5. The Transitional Rules Should Sunset After Three Years

Equally important as the rules themselves, is that they remain in force for only a brief period of time.[11] Thus, Northwest recommends that the Department adopt the rules Northwest has proposed, subject to a sunset date of three years after the effective date of such rules.

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These proposed rules offer a "third way" between the extremes of instant deregulation – which would only encourage the legacy CRSs to take advantage of their entrenched positions – and the Department's on-going and unwarranted micromanagement of the multifaceted airline-CRS-travel agent relationship. This provides the best means to recognize the changes in CRS ownership that have occurred, while at the same time acknowledging the reality of regulation-induced market distortions which, if left unaddressed, would continue to contribute to the exercise of CRS market power in a post-regulation environment.

II. The Department Should Reject Proposals For Immediate Deregulation Based On Claims That CRSs Do Not Possess Market Power

Some commenters attempt to justify immediate and total deregulation on the ground that changes in distribution technologies have diluted, or eliminated entirely, the CRSs' ability to exercise market power. This is not true. CRSs enjoy substantial market power and, if immediately freed from regulation without interim measures to reduce, and cabin the use of, that power, will only use the period following deregulation to consolidate and further entrench their position. For example, if CRSs were completely freed of regulation today, they would almost certainly continue to enforce parity clause in their contracts with airlines, preserving their ability to saddle airlines with unwanted and unnecessary levels of service at CRS-imposed prices. Moreover, if American's experience with Sabre is any guide, it can be expected that CRSs would

[11] *See also* United at 42; Alaska at 1-2; Orbitz at 59.

also seek to use parity clauses to stifle emerging competition from the Internet. *See* American at 4-5, 24-28. That is why transitional rules that address the key regulatory underpinnings of CRS market power are necessary to permit the emergence of competitive market forces on which the Department's deregulatory proposals are based.

Two indisputable facts belie any claim that there has been any serious abatement of the bargaining leverage of CRS systems. First, it remains the case that the major network carriers rely on travel agents to sell the majority of their tickets. In Northwest's case, approximately 65% of its 2002 revenues were derived from travel agent sales.[12] The figures for the other major carriers are in a similar range.[13] Because the vast majority of travel agents use only a single CRS,[14] from the point of view of airlines, one CRS is not a substitute for another so the major airlines must participate, at least to some degree, in each CRS. As such, it remains the case, as the Department of Justice observed in an earlier proceeding, that:

> Each CRS provides access to a large, discrete group of travel agents, and unless a carrier is willing to forego access to those travel agents, it must participate in every CRS. Thus, from an airline's perspective, each CRS constitutes a separate market and each system possesses market power over any carrier that wants travel agents subscribing to that CRS to sell its airline tickets. NPRM at 69376.

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[12] While the percentage of Northwest tickets sold through travel agents is lower, travel agents remain the most important distribution channel for reaching Northwest's most valuable business customers.

[13] *See, e.g.*, American at 18 ("Today, online and brick and mortar travel agents using CRSs still sell nearly 70 percent of American's tickets."); Delta at 5 (Delta sold only 26% of tickets through online channels in 2002); NPRM at 69378 (Delta obtains "64 percent of its revenues from traditional travel agents. . . . United has stated that it still derives more than seventy percent of its revenues from travel agency bookings.").

[14] According to the American Society of Travel Agents: "Use of a single CRS is a function of the market reality that multiple CRS's are highly inefficient for travel agencies, who therefore do not employ them." ASTA at 3.

Second, while Northwest shares the hope that the Internet will one day provide an effective means by which travel agents can bypass CRS systems, and thus reduce the systems' bargaining leverage over airlines, that is certainly not the case today. As even Sabre admits, travel agents book only about 10% of their reservations on the web. *See* Sabre at 6. And according to ASTA, the situation is not likely to change dramatically in the near future.[15]

Contrary to the CRSs' arguments, the current market structure has not contributed to competitive booking fees, but in fact induces conduct that achieves precisely the opposite result. CRS purchasing decisions are made by travel agencies, but the responsibility for payment for the services offered by CRSs falls on the airlines. Sabre's Comments actually underscore this very point, in highlighting the fact that "travel agents typically pay nothing to use a CRS and are, to the contrary, paid for using the systems." Sabre at 38. This disconnection between the purchase decision and payment responsibility creates perversely misaligned incentives. Travel agents have no incentive to shop for the CRS with the lowest booking fees, since they do not pay them. Indeed, because incentive payments made to travel agents by CRSs are funded, as Sabre admits, by booking fees, travel agencies actually have an incentive to choose the CRS with the highest booking fees. *See* Sabre at 15, 144; *see also* Statement of Douglas Wilson (App. 2 to Sabre) at 7 ("travel agents have forced most CRSs to pay them growing incentives which must be raised from booking fee revenues."). CRSs similarly have no incentive to reduce booking fees since they do not compete for the patronage of those (*i.e.*, the airlines) who pay them, but again, have the opposite incentive since they use booking fees to fund what Sabre describes as the "heated" competition among CRSs for travel agents' patronage. Sabre at 145.

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[15] *See,* e.g., ASTA at 13 ("Travel agencies therefore remain highly dependent upon CRS services for the vast majority of their bookings. There is no foreseeable market development that is likely to change that dependency."); *see also id*. at 33 ("the fact remains that productivity clauses in CRS contracts are a significant obstacle to travel agency adaptation to Internet booking options.").

In these circumstances, it is not surprising that the fees charged by CRSs to airlines are supracompetitive – and that CRSs have had the power to continue to increase those fees during a period of the worst financial stress faced by the airlines in the history of the industry. In Northwest's case, CRS booking fees have steadily trended upward from 1998, even as the percentage of tickets sold via CRS channels has declined.

Northwest's CRS Fees – 1998-2003 (Budget) ($000s)[16]

	1998	**1999**	**2000**	**2001**	**2002**	**2003 Budget**	**4-Year CAGR**	**5-Year CAGR**
CRS Tickets (ARC)	13,842	14,729	14,265	12,659	11,534	11,194		
Gross CRS Fees	146,964	161,548	169,308	174,779	168,839	175,145		
Ave. CRS Fee Per Ticket	**$10.62**	**$10.97**	**$11.87**	**$13.81**	**$14.64**	**$15.65**	**8.4%**	**8.1%**

The figures cited by other major airlines are similar. *See, e.g.*, American at 13 (showing a compound annual growth rate from 1995-2002 for CRS fees per net booking charged by the legacy CRSs ranging from 5.3-6.5%). At the same time, in contrast, the fees incurred by Northwest for other analogous electronic and data input expenses have declined or remained flat, as one would expect.

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[16] This table reflects Northwest's CRS fees over a five-year period. On Northwest's ledger, certain rebates that are paid to Internet sites are netted out from invoiced CRS fees for accounting purposes. In order to obtain the gross CRS fees, these rebates are added to CRS fees as reflected on Northwest's ledger. The invoice fees reflected in this table depict the actual CRS bills received by Northwest from the CRSs. Ticket data for all of 1998 is not available, so the amount indicated represents an estimate of annual ticket volume. ARC represents 98% of North America POS.

Northwest's Communications Costs – 1998-2003 (Budget) ($000s)[17]

	1998	1999	2000	2001	2002	2003 Budget	4-Year CAGR	5-Year CAGR
Air-to-ground, Voice and Data Communications Expenses	61,406	65,204	66,983	63,754	58,072	53,094		
Per Enplanement	1.22	1.16	1.14	1.18	1.10	0.98	**-2.4%**	**-4.2%**

Northwest's IT Processing Costs – 1998-2003 (Budget) ($000s)[18]

	1998	1999	2000	2001	2002	2003 Budget	4-Year CAGR	5-Year CAGR
Information Services Department Operating Expense	170,655	190,930	188,835	190,736	177,873	183,339		
Per Enplanement	3.38	3.40	3.22	3.53	3.38	3.39	**0.0%**	**0.1%**

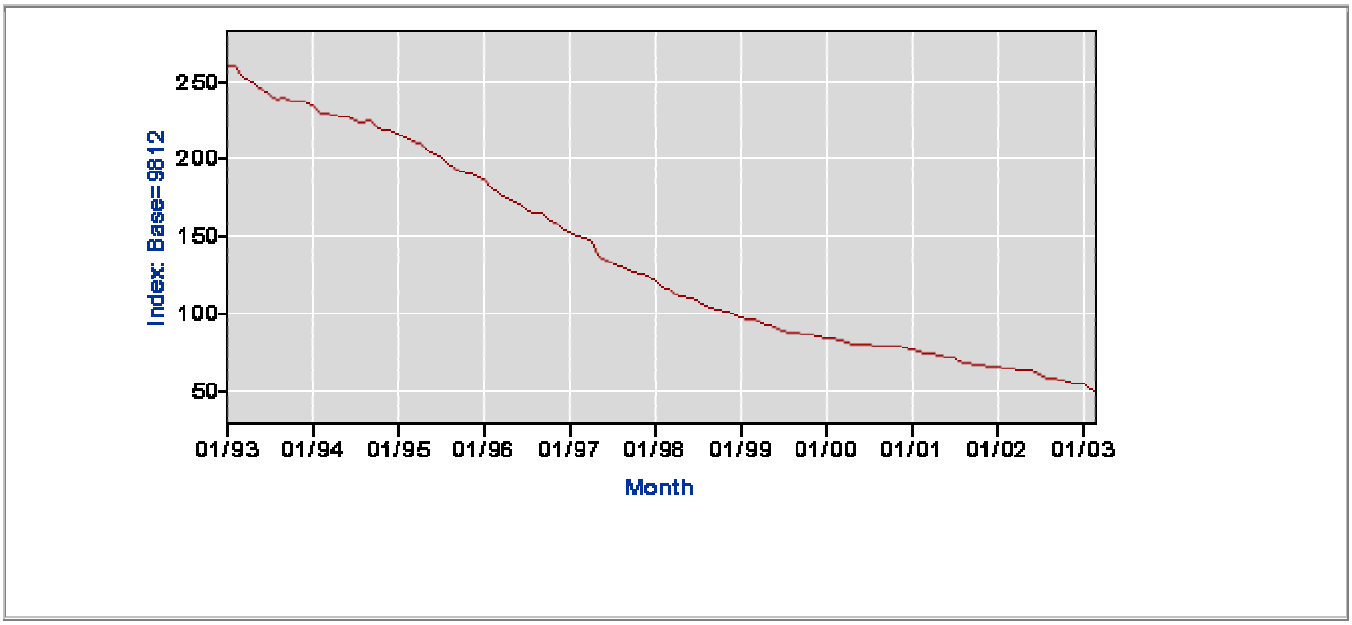
The CRSs argue that booking fees are not, in fact, excessive. But their analyses either measure the wrong thing, or compare booking fees to the wrong yardstick. For example, Sabre's consultant, Douglas Wilson, claims that booking fees are not excessive because they have not risen more rapidly since 1990 than the Producer Price Index for Air Travel. *See* Sabre, App. 2 at 8-10. In the first place, if changes in distribution patterns actually had created competitive pressure on CRS booking fees as the CRSs claim, one would expect to see declines in such fees, not increases as Sabre's own data shows. Second, even if a comparison in the rate of increase

[17] "Communications costs" represent all communications costs other than air navigation fees which are radar-related and imposed by foreign governments. The data represents air-to-ground communications as well as voice and data communications.

[18] "IT Processing Costs" are costs related to information services, *i.e.*, business application support, IT infrastructure, and telecommunications/network support.

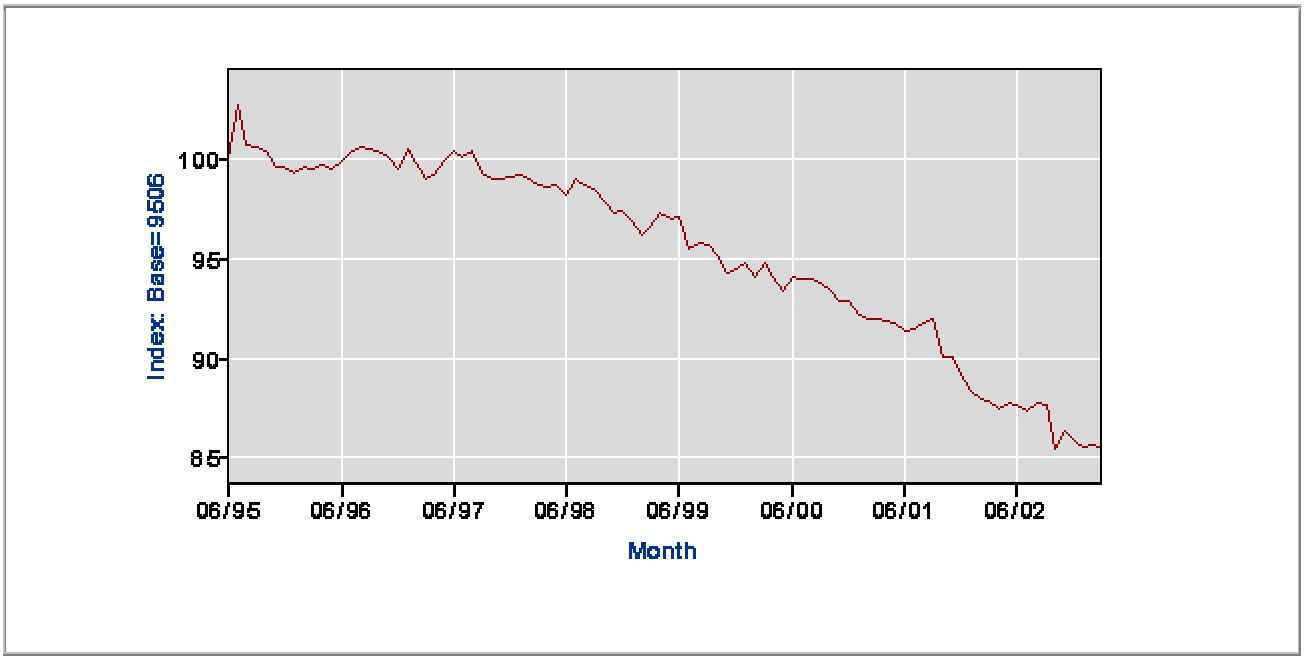
between booking fees and some measure of inflation since 1990 were relevant, one would need to compare the rate of increase in booking fees with an index reflecting the costs of similar inputs. But the inputs for air travel and CRS services are not even remotely similar, with the former consisting primarily of aircraft costs, insurance, fuel and wages, and the latter consisting primarily of computing and telecommunications. When one makes a more appropriate comparison, the results are strikingly different. For example, the Producer Price Index for electronic computers and telephone communications reflect substantial declines over similar periods of time,[19] while CRS fees are substantially increasing, as even Sabre's data show.

PPI For Electronic Computers



[19] Source: United States Department of Labor, Bureau of Labor Statistics.

PPI for Telephone Communications (except radiotelephone)



Sabre also attempts to support the argument that booking fees are not excessive by pointing to what is described as the "slow growth" in net booking fees. *See* Sabre, App. 2 at 17-19. Net booking fees are simply the gross fees charged to airlines, net of incentive payments made to travel agents. The net fee, however, is irrelevant to whether the booking fee charged to airlines is supracompetitive. Even if the net fee had declined, all that it would show is that CRSs are transferring some of their supracompetitive profits to travel agents. As it is, net booking fees have actually continued to increase, showing both increases in CRS profits and a transfer of a portion of CRS monopoly rents to travel agents as a means of locking them into long-term contracts. Thus, not only is the trend shown in net booking fees irrelevant to whether the gross fees charged to airlines excessive, it, in fact, only underscores the forces that continue to contribute to ever increasing fees.

Finally, the chart that Sabre submitted on May 1, 2003, is also off the mark. Sabre purports to estimate airlines' distribution costs through various channels and, not surprisingly,

comes to the conclusion that costs for bookings made through travel agencies using CRSs are roughly the same as those for bookings made through third-party online agencies and Orbitz, and substantially less than bookings made through the airlines' own web sites or offline reservations. Northwest's experience, however, completely refutes this. Its gross cost for tickets issued through brick and mortar travel agencies is more than twice that of online agencies and nearly five times the cost of reservations made through its own web site.

III. The Department Should Reject Proposals To Retain Or Expand Regulation

Consistent with its deregulatory approach to the airline ticket distribution market, Northwest believes that subject to the four exceptions discussed above, the Department should sunset its CRS regulations at the conclusion of this proceeding. In the following subsections, Northwest addresses several of the specific rules discussed in the NPRM and the initial comments.

A. The Mandatory Participation Rule Must Be Repealed

Perhaps more than any other CRS rule, the mandatory participation rule, 14 C.F.R. § 255.7, is responsible for constraining, rather than promoting, vibrant competition among systems. Thus, it comes as no surprise that the Department's well-reasoned intention to eliminate this rule has drawn the attention of nearly every commenter. As set forth in its opening comments, Northwest strongly supports the elimination of this rule. Northwest at 7-8. First, the exit of airlines from the CRS business has undermined the rule's original purpose of preventing airlines from withholding participation in systems that they did not own so as to favor those that they did own. Second, the continuation of this rule would serve no purpose other than allowing

the legacy systems to escape the market discipline that is the inevitable product of having to compete for each airline's participation.[20]

The divergent voices that share this view are a testament to the wisdom of repealing the rule.[21] Although support for repealing the mandatory participation rule is not universal, those who advocate its retention or expansion do so based on mistaken premises or in a transparent effort to hinder the development of competitive alternatives to the CRS/travel agent distribution channel. Most glaringly, the Large Agency Coalition urges the Department to adopt a "universal participation rule" which would mandate that every carrier publish every public airfare in all channels of distribution. *See* Large Agency Coalition at 39. This proposal, of course, is diametrically in opposition to the Department's movement toward a less regulated airline ticket distribution market. More importantly, it would thwart the achievement of a fundamental goal of this proceeding – encouraging the development of competitive alternatives to CRSs.

Other opponents of eliminating the rule are somewhat less sweeping, though equally misguided. British Airways, for example, believes that elimination of the rule would benefit only large, U.S.-based airlines. It states: "By contrast, smaller and unaffiliated airlines may have little or no ability to bargain for better terms." British Airways at 6. That argument makes no sense. Even now, airlines that do not have an equity interest in a legacy system are not bound by the mandatory participation rule, so their bargaining position, as a technical matter, vis-à-vis systems will be unaltered by the elimination of the rule. However, as a pragmatic matter, such

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[20] The feature of the current rule which permits airlines to decline participation if the CRS's terms are not "commercially reasonable," 14 C.F.R. § 255.7, is, pragmatically, of little value, because the CRSs combine and price various products and features in different ways, rendering a meaningful comparison and, thus, a demonstration of comparative unreasonableness, virtually impossible.

[21] *See, e.g.*, American at 29; AITAL at 3; Air Canada at 12; America West at 38; Lufthansa at 3; Orbitz at 33,; Singapore Airlines at 1; Worldspan at 28.

airlines themselves are likely to benefit from the innovation and competition that is catalyzed by the systems having to bargain with major U.S. airlines for the terms and features of participation. This is a classic case of the axiom that a rising tide lifts all boats.

Finally, the all-or-nothing approach advocated by Travelocity – eliminate mandatory participation but only in the context of complete deregulation (Travelocity at 11-12) – is fine in theory, but does not account for the realistic need to manage an effective migration from a regulatory regime that has had the perverse effect of limiting CRS competition.

In short, the Department's tentative conclusion that the mandatory participation rule's time has passed is absolutely correct. The rule should be eliminated.

B. <u>The Antidiscrimination Rule Should Be Abolished</u>

Along with the mandatory participation rule and the ancillary enforcement of parity clauses by systems, the prohibition on systems charging airlines unreasonably discriminatory booking fees, 14 C.F.R. § 255.6(a), has served to entrench CRS bargaining leverage and foreclose any chance of negotiating lower booking fees. If there were any doubt about this, it would be removed by Amadeus' admission that "repeal of these rules effectively frees airlines to bargain for more advantageous booking fees." Amadeus at 21. The Department wisely has recognized this uncontrovertible fact. *See* NPRM at 69399. The Department's observation accurately reflects Northwest's experience, and Northwest therefore agrees with the Department's proposal "to eliminate the prohibition against discriminatory fees." *Id*.

The manifest problems created by the regulation of booking fees, and the overwhelming need to remedy these problems immediately, are clear. In particular, once the mandatory participation rule is eliminated, the simultaneous removal of the booking fee rule will eliminate regulatory obstacles to the ability of "all airlines . . . to negotiate freely with systems over prices,

as well as terms and conditions, and to decide whether to participate in each system." Continental at 25-26.

As with the mandatory participation rule, opponents of eliminating the booking fee rule struggle in vain to substantiate their argument with conjecture and dire prophecies of what will happen in an unregulated environment. For example, Air France contends that only large, U.S.-based airlines will be in a position to negotiate favorable fees, whereas smaller U.S. airlines or foreign carriers will not enjoy such leverage. *See* Air France at 5-6; *see also* America West at 21-22 ("Ending this prohibition will not only fail to eliminate the market power of CRS vendors over most airlines, it could easily result in a substantial shift in costs from the largest incumbent carriers to smaller low-fare carriers – directly harming consumers."); Midwest at 20 ("Indeed, to whatever degree any of the major carriers can negotiate a discounted fee, the systems will undoubtedly raise their fees to other carriers to make up for any revenue lost."); Southwest at 5 (same); US Airways at 21 (same).[22] That argument is unfounded. The Department should not retain a rule merely because its elimination may result in some competitors obtaining more favorable arrangements than others. Indeed, such an outcome is fully consistent with the operation of competitive markets. The Department's goal must be to enhance competition, not intervene in markets to advance the competitive position of any particular competitor.

In any event, it is far from certain that such an outcome would materialize. Once CRSs no longer are bound by the strictures of the antidiscrimination rule, they will have the incentive to develop new and lower fee schedules to try to attract carriers who previously have not participated in their systems by offering prices and service levels consistent with such carriers'

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[22] Amadeus, not surprisingly, embraces this reasoning as well, *see* Amadeus at 22, since it, along with the other legacy systems, are the primary beneficiaries of the current rule.

business models. Indeed, the CRSs appear to be doing just that, even with the rule in place – offering packages of services and prices designed to appeal to low fare carriers, and available only to a defined category of carriers that happens to include only low fare carriers. *See* American at 32-33.

C. Tying Of Override Commissions And Other Marketing Benefits To A Travel Agent's Use Of A Particular System Should Not Be Regulated

Section 255.8(d) of the Department's rules forbids an airline from tying override commissions (*i.e.*, the payment to a travel agency for booking a designated percentage of its flights on a given airline) to an agency's use of an airline-owned system. *See* 14 C.R.R. § 255.8(d). The Department is considering expanding the rule's reach to marketing benefits (such as corporate discount fares) linked with the usage of a particular system. *See* NPRM at 69409 (requesting comment on such a proposal). In light of the imminent demise of airline ownership of CRSs, Section 255.8(d) is no longer needed and, for the same reason, certainly should not be expanded beyond its current scope. The decoupling of airline-CRS ownership means that airlines will have only one reason to incentivize travel agents to favor one system over another – to obtain lower booking fees or greater efficiencies. There is nothing remotely nefarious about such conduct, and its net effect will be to benefit consumers.

ASTA takes a different view, opposing any tying practices by airlines. *See* ASTA at 39-40. In doing so, however, it fails to explain how an airline's advocacy of a particular system harms competition. Instead, it makes the vague claim that "[t]ying distorts competition in the tied market and interferes with rational business planning." *Id*. at 40.[23] While ASTA's unexpressed, but apparent, desire to maintain maximum flexibility for its constituents is to be

[23] Amadeus also supports an expansive anti-tying rule. *See* Amadeus at 86-92. Presumably, it does so because it believes that such a rule would advantage it in competing against other systems. Once again, however, it is not the Department's place to pick winners and losers in the market.

expected,[24] the Department should decline ASTA's subtle invitation to pick favorites in the industry at the expense of forestalling the emergence of a competitive market for airline ticket distribution. In such a market, if a travel agent believes that an airline is unjustifiably endorsing a system through marketing benefits, that agent will be free to weigh the relative value of such benefits and determine whether subscription to the system is in its best interests. If enough agents determine that it is not, there is a good chance that the airline will revisit its marketing program. That is the essence of a free market.

D. Regulating The Availability Of MIDT Data Is Both Unnecessary And Harmful

1. The Record Remains Overwhelming That Use Of MIDT Promotes Competition And Efficiency

In the NPRM, the Department found that: (1) the MIDT "data that can be derived from the bookings made through each system are invaluable for marketing purposes;" (2) airlines "use the data for marketing and research and route development purposes and to make decisions on pricing and revenue management" and for administering and tracking "override and corporate discount fare programs;" (3) "airlines can and often do use the data for legitimate purposes and . . . markets usually operate better when firms have more information;" (4) both large and small airlines use the data; and (5) airlines have made "significant investments in developing the ability to process and analyze the marketing and booking information . . . [and] systems have made significant investments of their own." NPRM at 69401-69404. The current record, as supplemented by the last round of comments, only underscores the fundamentally pro-competitive and efficiency-enhancing uses of the MIDT data and the costs to efficiency,

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[24] ASTA's motivation is confirmed by the fact that a leading travel agent echoes ASTA's call: "An airline should be precluded from tying access to its corporate discount fares to a travel agent's use of a system marketed by the airline." Wagonlit at 17.

competition and the market participants that would be incurred if use of such data were restricted. That record shows:

- The availability of accurate and timely data allows markets to perform more efficiently.[25]
- There is no evidence of a market failure that would justify restriction of MIDT data. There is no lack of competition, prices (*i.e.*, airfares) are low and there is no evidence (a gross understatement) of monopoly profits.[26]
- Many of the very carriers that claim to be disadvantaged by the use of MIDT data are growing, and outperforming the major network carriers, the claimed beneficiaries of anticompetitive use of such data.[27] Indeed, many of these same airlines are among the least represented in MIDT data because a large percentage of their sales are through direct and Internet channels, with the result being that such sales are not reflected in MIDT data.
- MIDT data constitutes the best source of information on market demand and is used by network carriers for critical network planning functions. The timeliness of such data is critical since the product sold by airlines is perishable. Restrictions on the timeliness or scope of such data would make route and capacity planning less efficient, increasing costs and degrading network performance.[28]
- MIDT data is an efficient way to monitor travel agency override agreements and some corporate contracts. Without agency specific data, these programs would become more costly to the airlines, impairing their ability to reward agency performance and reducing the level of discounts made available to corporate customers, and might even be eliminated entirely.[29]

2. The Latest Comments Offer No Support For Restricting MIDT Data

Against the demonstrated and tangible pro-competitive and efficiency-enhancing uses to which airlines put MIDT data, proposals to restrict its availability rest solely on speculation regarding "possible" future misuse and wholly factually unsupported and highly generalized claims of past misuse.

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[25] *See, e.g.*, Worldspan at 34; Air Canada at 21; American at 43; Delta at 22; United at 32; Galileo at 74.

[26] *See, e.g.*, Dorman Aff. at 12 (Ex. 3 to American).

[27] *See, e.g.*, Southwest at 12-14; ACCA at 4-12.

[28] *See, e.g.*, American at 41; Continental at 23; US Airways at 13.

[29] *See, e.g.*, Galileo at 74; American at 41; Qantas at 2; United at 33.

The latest round of comments offers no more basis for regulating the provision of MIDT data than the prior unsubstantiated assertions on which the NPRM relies in proposing to do so. In the main, the proponents of regulation seek to restrict the provision of MIDT data on the ground that it can be used in implementing anticompetitive schemes to impede competition from small carriers. These commenters hope that the Department will accept these arguments as a sufficient basis for using this proceeding, which purports to deal with CRS market power, instead to regulate competition among airlines in a way that will tip the competitive balance in favor of carriers whose business model does not rely on sophisticated data analysis to optimize highly complex hub-and-spoke networks. But the arguments they advance only serve to highlight the rank speculation on which the proposals to regulate the provision of these data rest. For example, ACAA, one of the chief proponents of regulation, can muster no better than the following in support of restricting MIDT data: "Imagine what those combined carriers [the UA/US and CO/DL/NW alliances] could do in their joint marketing and scheduling efforts if they are permitted to obtain and utilize MIDT data." ACCA at 7. Quite apart from the fact that resort to imagination can hardly supply a "rational basis" for reversing 20 years of Department policy concerning MIDT data, the Department is well aware that neither alliance allows the carriers to take joint action against competitors and that both alliances remain fully subject to the antitrust laws.

Equally untethered to any facts is America West's claim that an "airline that dominates a particular market can use this information to protect (and expand) its dominate [sic] position by pressuring travel agents to lower bookings made for competitors. Typical mechanisms include withholding services needed by agencies. These could include denying access to an airline agency help desk or eliminating sales calls to a particular agency. Other pressure tactics are the

availability or non-availability of discounted fares that an agency can use to win or keep corporate customers." America West at 29. Nowhere does America West contend that any major airlines have actually employed any of the "pressure tactics" that "could [be] include[d]" in the "mechanisms" it claims major airlines "can use" to withhold "services needed by agencies," much less, provide any evidence of such conduct.[30]

Other commenters barely disguise their own self-interest in advocating restrictions on the provision of MIDT data. Travel agents, for example, are only too happy to accept override commissions. Thus, for example, the American Society of Travel Agents, strongly resists any attempt to limit the payment of override commissions to its members: "Despite much theorizing by various parts of the government on this subject, there is no meaningful evidence that override commissions have ever in fact interfered with consumer welfare. Override or bonus commissions are the last vestige of airline compensation of travel agencies and produce an income stream that is crucial to the profitability of some agencies." ASTA at 40. Yet, ASTA would like to deprive airlines of the tools that allow them most efficiently to monitor the travel agency performance that would entitle them to such commissions. *Id*. at 40-41.

Corporate customers similarly welcome performance-based discounts. *See generally* National Business Travel Coalition. But they too urge the Department to tie the hands of airlines in negotiating and administering such discounts by eliminating their access to the data that would allow them most efficiently to structure contracts and monitor performance: "It is the concern of our membership that this uniformly required data disclosure as a condition of getting any discount in fact provides airlines with a level of information that will impair the ability of a

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[30] *See also* Wagonlit at 14 ("In essence, the airline can structure incentives to prevent travel agents from using a rival airline, rather than have to use incentives to attempt to attract the subscriber's business. . . . [W]hen the dominant airline can identify the specific corporate customers, the airline can develop tactics to deter those customers from using a rival airline.") (emphasis added).

corporation to negotiate effectively fairly with competing airlines." *Id*. at 21. While the financial interests of travel agents and business customers that would be served in tilting negotiation of performance awards in their favor is obvious, it provides no "rational basis" for restricting airline access to MIDT data.

3. Restricting MIDT Data Would Exceed The Department's Section 411 Authority And Violate The Administrative Procedure Act

The Department describes its authority under Section 411 as reaching practices "that violate[ ] the antitrust laws or antitrust principles." NPRM at 69384. One of the most bedrock of those principles is that the antitrust laws are intended to protect competition, not competitors. *See, e.g.*, Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc., 429 U.S. 477, 488 (1977) (*quoting* Brown Shoe Co. v. United States, 370 U.S. 294, 320 (1962)) ("The antitrust laws, however, were enacted for 'the protection of competition, not competitors[.]'"). Yet, the Department's proposal to restrict the availability of MIDT data is aimed squarely at protecting the latter, not the former. MIDT data has been made available to airlines for nearly 20 years under the current regulations. Those who propose restricting access to such data, however, have been unable, in several rounds of comments, to come forward with any substantiated use of such data to harm competition.

In the absence of any such evidence, the Department attempts to justify regulation based on its view that it is necessary to tilt the competitive playing field in favor of low fare carriers in order to counterbalance the perceived competitive advantages of major network carriers:

> Another feature of the airline industry makes it all the more important to block the systems' sale of the data tapes insofar as the data can be used against competing airlines. The competitive advantages created by a hub airline's more comprehensive route network and more frequent flights make it difficult for other airlines to compete at that airline's hub, unless they are serving the city from their own hubs . . . . Since competing with the incumbent airline will be tough at best for the entrant, we think it important that the entrant not suffer the further disadvantage of having the incumbent airline know in advance how many seats are

> being sold on each of its flights by individual travel agencies. NPRM at 69403.

This sort of competitive handicapping not only is unsupported by evidence of any conduct that violates the antitrust laws or antitrust principles, but it is fundamentally at odds with those principles, and thus beyond the Department's stated view of its authority under Section 411.

The Department's alternative rationale – that restricting MIDT data will "make it harder for airlines to implement override commission programs" – is equally inconsistent with the Department's own view of its authority under Section 411. *Id*. at 69404. The NPRM explicitly makes no finding "that override commissions are anticompetitive." Indeed, as the Department notes, they are consistent with the common practice of "reward[ing] distributors for producing higher sales." *Id*. Since override commissions themselves are not anticompetitive, attempting to curtail them through the backdoor device of making them more difficult and costly to implement cannot be justified as necessary to remedy conduct that is violative of antitrust laws or principles.

Moreover, the Department's proposal cannot be squared with Administrative Procedure Act ("APA") requirements that the Department engage in reasoned decision-making. The APA itself provides that a reviewing court must "hold unlawful and set aside agency actions, findings, and conclusions found to be arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law . . . ." 5 U.S.C. § 706(2)(A). That requirement mandates that an agency decision must find factual support in the record.

> [T]he agency must examine the relevant data and articulate a satisfactory explanation for its action including a "rational connection between the facts found and the choice made." Burlington Truck Lines v. United States, 371 U.S. 156, 168 (1962). In reviewing that explanation, [a court] must "consider whether the decision was based on a consideration of the relevant factors and whether there has been a clear error of judgment." Bowman Transp. Inc. v. Arkansas-Best Freight Sys., 419 U.S. 281, 285 (1974); Citizens to Preserve Overton Park v. Volpe, 401 U.S. 402, 416 (1971). Normally, an agency rule would be arbitrary and

> capricious if the agency has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise.

Motor Vehicle Mfr. Assoc. of the United States v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983). If an agency action is "devoid of needed factual support[,]" courts will strike down such action as arbitrary. Association of Data Processing Serv. Org., Inc. v. Board of Governors of the Federal Reserve Sys., 745 F.2d 677, 683 (D.C. Cir. 1984) (Scalia, J.).[31] *See also* American Telephone & Telegraph Co. v. FCC, 974 F.2d 1351, 1354 (D.C. Cir. 1992) (Courts "will not uphold an agency's action where it has failed to offer a reasoned explanation that is supported by the record."); W.C. Nelson v. United States, 64 F. Supp.2d 1318, 1323 (N.D. Ga. 1999) (*citing* Atlanta Gas Light Co. v. F.E.R.C., 140 F.3d 1392, 1397 (11th Cir. 1998)) ("[T]he court must determine whether a rational connection exists between the facts found and the choice made.").

A decision by the Department to restrict the availability of MIDT data cannot withstand scrutiny even under the relatively deferential standard of review that courts employ to ascertain whether administrative actions are arbitrary and capricious. As discussed above, the record is devoid of any factual support for a finding that there is a demonstrative problem, competitive or otherwise, with airlines' use of MIDT data that merits the Department's intervention. Indeed, it is difficult, if not impossible, to conceive of any facts – as opposed to conjecture and

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[31] Then-Judge Scalia also observed: "When the arbitrary or capricious standard is performing the function of assuring factual support, there is no *substantive* difference between what it requires and what would be required by the substantial evidence test [5 U.S.C. § 706(2)(E)], since it is impossible to conceive of a 'nonarbitrary' factual judgment supported only by evidence that is not substantial in the APA sense – *i.e.*, not 'enough to justify, if the trial were to a jury, a refusal to direct a verdict when the conclusion sought to be drawn . . . is one of fact for the jury.'" 745 F.2d at 683-84 (emphasis and alteration in the original) (citation omitted).

unsubstantiated prognostications – whatsoever that the Department could muster to support such a decision. In the absence of solid factual support, the imposition of a new regulatory system would be unwise, arbitrary and an invitation to reversal by an appellate court. By the same token, if the Department's real agenda is to curtail the use of override commissions, then it is obligated under the APA to clearly show its hand and articulate a sound factual basis supporting such a decision. As explained above, no such grounds exist, and the law does not allow the Department to end-run its statutorily-imposed decisional requirements by doing indirectly that which it has no authority to do directly.

E. Internet Distribution Should Remain Unregulated

One clear lesson from the experience of CRS regulation is that rules have unintended consequences. Even rules which seem well-intentioned and well-justified when adopted may, as market conditions evolve, not only prove themselves incapable of serving their original purpose, but also may act to undermine the benefits they sought to create. That lesson should serve as a strong cautionary note to the Department as it considers whether to regulate the nascent and competitive Internet channels of airline ticket distribution. Northwest urges the Department to follow its inclination and not to adopt rules regulating the Internet distribution of airline tickets.

Today, on-line agencies and airlines' proprietary Internet sites operate in a competitive market, notable for rapid technological change, the constant development of novel services and features, and disciplined by the ease and frequency with which consumers move from site-to-site in search of the route and fare that best suits their needs. For all of these reasons, the rampant competition on the Internet, which underscores the competitive imbalances in the CRS distribution channel, is a poor candidate for regulation.

One reason to forego Internet regulation, as Northwest noted in its comments, is because "it would be difficult, if not impossible, to construct a regulatory regime that could anticipate all

of the permutations that may arise in coming years." Northwest at 19. Others agree.[32] Another reason is that, in due course, the Internet will be the best check on CRS market power.[33]

Moreover, it is not credible to suggest that "the growth of on-line travel agents indicates that they are gaining market power similar to system owners, thereby justifying their regulation by the Department." Midwest at 9. Even Midwest acknowledges, as it must, that that the three major on-line travel agents only account for approximately 10% of domestic airline sales. *Id*. at 9 n.4. The surest way to allow this medium to flourish, increasing its market share while eroding the CRS bottleneck, is to let it develop unencumbered by regulatory constraints. Orbitz, for example, has been a catalyst for airlines finding ways to bypass CRSs and, at least in Northwest's case, has yielded substantial cost savings.[34] Further, if any problems emerge, "the enforcement process would be the best means for addressing any problems with deceptive practices and unfair methods of competition created by such a site." NPRM at 69413.[35] There is simply no basis in the record – or the market – to regulate with the heavy hand that Midwest proposes, when ample means of case-by-case enforcement already exist.[36]

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[32] *See, e.g.*, AAPA at 9; Delta at 5.

[33] *See, e.g.,* Continental at 5; Orbitz at 41.

[34] Several commenters point to Orbitz, generally, and its MFN clause, specifically, as a reason to extend Part 255 in some measure to the Internet. *See, e.g.*, Galileo at 41-59; *id*. at App. 2 (Professor Hausman, "Effects of Orbitz"). Setting aside Galileo's obvious self-interest in weakening Orbitz, the Department should decline to apply its regulations to Orbitz. The Department has twice looked at Orbitz in great detail, determined that it is pro-competitive, and retains the necessary enforcement tools to revisit the issue if the need arises.

[35] Southwest, in advocating the regulation of Orbitz, maintains that "any distribution venture that is collectively owned by a consortium of airlines, and that purports to offer an integrated display of fares and service to the public or travel agents, should be subject to the Department's rules against anticompetitive actions." Southwest at 9. This argument, however, simply ignores the fact that public and private enforcement of the antitrust laws are designed and able to address this very concern.

[36] Consistent with its well-reasoned "wait and see" approach to the Internet, NPRM at 69410, Northwest reiterates that the Department should refrain from adopting rules with respect to: on-line displays of airline services (see NPRM at 69411); requiring "that airlines treat all types of travel agencies

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F. Equal Functionality And Default Features Rules Should Be Eliminated

The Department is mistaken in its proposal to readopt rules that require "equal access to enhancements and equal treatment on the loading of information, and . . . bar systems from using default features that favored the airline owning the system." NPRM at 69398 (citing 57 FR 43810-43816). *See also* 14 C.F.R. § 255.5. To the extent that this rule was rooted in a concern that "each system's architecture was biased in favor of the owner airline[,]" NPRM at 69398, the severing of airline-CRS common ownership should put to rest any fears of undue influence. Instead, like the rules discussed elsewhere in these Reply Comments, this rule should be discarded so that system architecture, like other terms and conditions of the airline-system relationship, can be dealt with through an equitable bargaining process in which the parties can engage in the unfettered negotiation that is the signature of a deregulated industry.

British Airways argues that "[i]n order to keep the playing field level and ensure that all airlines are treated equally by the CRSs this rule should be retained and applied to all CRSs." British Airways at 4. Yet, while reflexively supporting this and other antiquated rules, British Airways fails to explain why this rule should outlive the airline-CRS equity relationships that were its genesis. In any event, the threat of architectural bias is likely limited by the need of CRSs to offer competitive products to travel agents.[37] Finally, the mere fact that such rules may not have been "unduly burdensome" in the past, NPRM at 69398, does not warrant retaining them in the future because the assumption on which they were predicated is no longer valid.

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the same, to treat on-line travel agencies the same as off-line travel agencies, or to give all travel agencies access to fares that the airline has chosen to sell through limited channels" (NPRM at 69413); governing the conduct or operating terms of joint airline websites (see NPRM at 69413).

[37] *See, e.g.*, Mercatus Center/GMU at 12.

G. The Frequency Of Code Share Displays Should Not Be Regulated

The Department should not regulate the number of times code share services can be displayed in CRSs. First, as the Department has recognized, code sharing "provide[s] significant consumer benefits." NPRM at 69397. In order for those benefits to be realized, consumers must have access to accurate information about the services being provided – and multiple listings of code share services, in fact, are necessary to provide such accurate information. The Department should therefore be wary of imposing regulatory limitations that would limit access to such information, likely reducing the benefits of code sharing to both consumers and the code share partners.

Second, to the extent that there is any legitimate concern that certain levels of multiple listings of particular code sharing services provide misleading information to travel agents and consumers, the market is fully capable of making appropriate adjustments; in fact, the market will drive any such adjustments demanded by consumers or travel agents. Travel agents compete for consumers and have strong incentives to adjust CRS screen displays in ways that will allow them best to serve their customers. Travel agents already possess the capability to modify screen displays in a number of ways to eliminate perceived "screen clutter" and to prioritize flights. And there is no barrier to travel agents implementing whatever additional software or hardware they might believe necessary to expand or refine these capabilities. There is also no reason to believe that CRSs will not be responsive to travel agent demands to tailor screen displays in ways that agents believe allows them to best serve their customers.

Those who advocate regulation of code share displays offer no reason why regulation rather than market forces ought to determine the most efficient levels of code share screen displays. American, for example, refers to "the pernicious effects of screen padding." American at 35. But if the effects are, in fact, "pernicious" not because they are regarded by American as

disadvantageous to the business model it has chosen, but because they provide inaccurate or confusing information, the market is fully capable of remedying such effects.

Southwest likewise fails to offer any actual evidence of cognizable competitive impairment attributable to the manner in which code share flights are displayed. *See* Southwest at 10-12. This is not surprising since Southwest participates only in a single CRS and only to a limited degree. It would therefore be a rare occurrence that Southwest is affected at all by code share screen displays, much less in a way that harms competition, as opposed to effects that are a natural consequence of accurate and informative listings of code share flights.

In sum, there is no compelling reason for the Department to involve itself in dictating the manner in which CRSs display code share flights and every reason to believe that any valid concerns with respect to code share displays will be most efficiently addressed by the market.

CONCLUSION

For the foregoing reasons, and the reasons set forth in the Comments of Northwest Airlines, Inc., the Department should allow CRS regulation to sunset, with the exception of the four limited rules set forth above, which would sunset three years after their adoption.

Respectfully submitted,

/s/ Megan Rae Rosia /s/
Managing Director, Government Affairs
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